The Record

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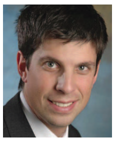
ABCs of RRSPs



By: Mike Magreehan

After many discussions with several prospective clients, I realize that my role has become that of a financial educator. An investor should understand all of their options and ultimately comprehend their investment decision. Further, an investment decision should fit into an overall financial plan.

With the March 1st deadline approaching, I thought it would be appropriate to highlight the importance of a properly structured RRSP, and the effectiveness of mutual funds, in developing a foundation to a sound financial plan.

What is a Registered Retirement Savings Plan?

An RRSP is an important tool designed to assist you in planning for your retirement – while saving you tax today. Essentially, it is a self-funded retirement plan. As the Contributor, you receive two main benefits for making deposits to an RRSP: (1) a tax-deduction on your contribution, and (2) tax-deferred compound growth on your investment.

Picture your RRSP as a house. As long as money remains outside the house, it is within the tax man's grasp – any income earned on that money is taxable each year. For instance, tax is payable each year on any GIC interest you earn outside your RRSP. If your money is inside the house, it is tax-sheltered.

The first advantage of an RRSP is the tax-deduction received on your contribution. If you earn $50,000 annually, your marginal tax rate is 31%. Therefore, if you contribute $1,000 to your RRSP, you will receive a tax refund of $310. The result – you have $1,000 saved inside your RRSP, while the contribution only cost you $690 out-of-pocket.

Once you make your RRSP contribution, you must decide on which room in the house it is to reside in. The room represents the investment selection, and this is where the second benefit comes into play. You are able to move that investment from room to room, without incurring any tax penalties. As long as your investment remains inside the house, you have full investment flexibility and it is able to grow and compound tax-free.

There are over 5,000 mutual funds available in Canada. Add on the endless number of stocks and bonds, and this decision can be overwhelming. A qualified investment advisor can assist you in this regard.

What is a Mutual Fund?

Mutual funds can build an excellent RRSP foundation, and they are an efficient way to build a broadly diversified portfolio. A mutual fund is essentially a basket of investments, such as cash, bonds, equities, income trusts, or a combination thereof.

By owning a mutual fund, you own fractional shares in the mutual fund's underlying investments – and quite often, these investments are a diversified collection of publicly traded companies. The mutual fund manager's responsibility is to buy and sell the fund's underlying investments with the intention of preserving and growing your capital.

There are limits on how much you may contribute to your RRSP each year. The maximum this year is 18% of your 2003 earned income, or $15,500 (whichever is less). A qualified investment advisor can assist you in selecting appropriate investments and can show you strategies to plan for your retirement. Financial success is charted by a road map, and your journey begins here.

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